

August 1, 1979

LETTER 762

July 20, DJIA 828.07; PTI 1042; A-D Ratio -18.78
July 27, DJIA 839.76; PTI 1059; A-D Ratio -18.21

THE PICTURE: Long-time readers of these Letters know that I believe in the thesis that people get "what they need," not necessarily what they want (demand) or what they think they need. I have been pondering the American economic, social and political scene, and it seems to me that the powers above are attempting to *wake up* this great nation.

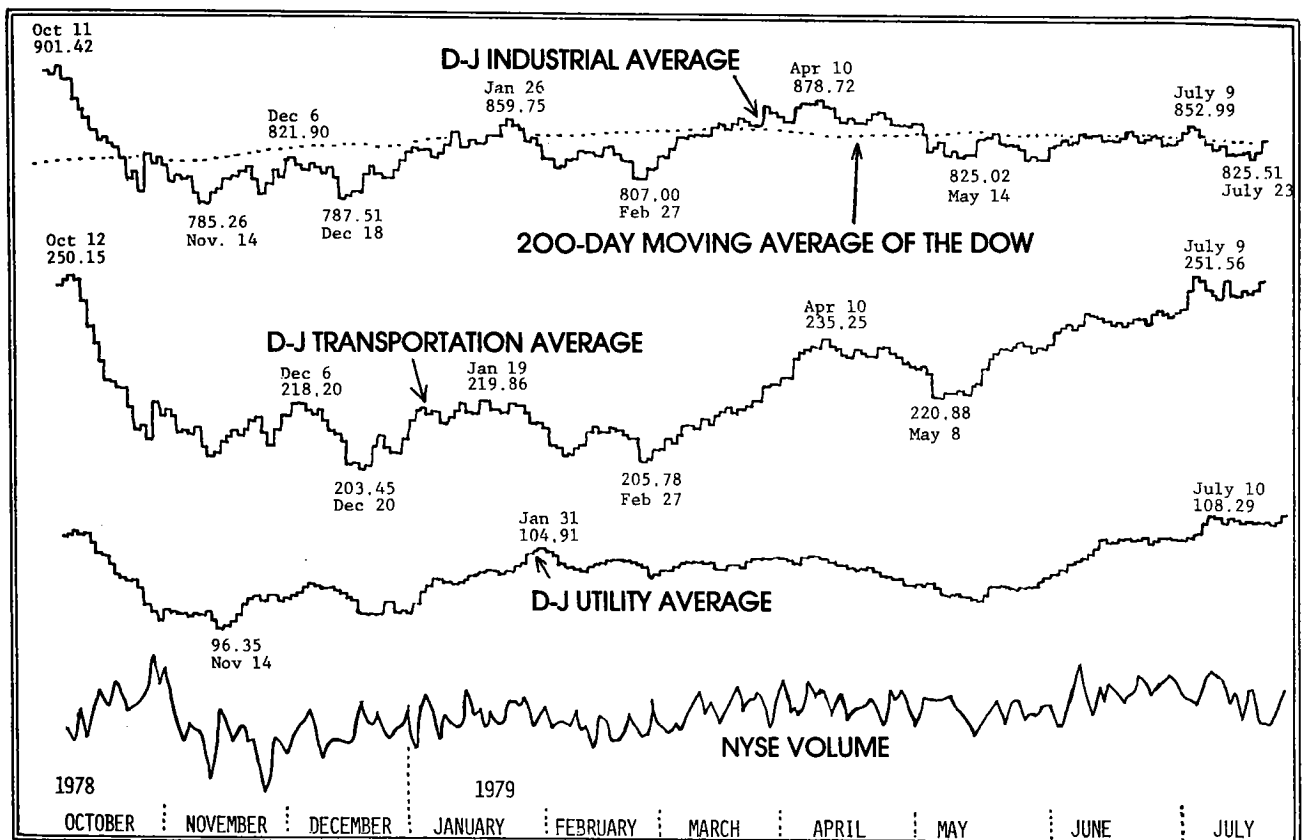
Look at the facts. We had John Kennedy, a President who was assassinated (literally shot out of office). Then we had Johnson, a President who was forced to quit (let's say he was blown out of office). Next we had Mr. Nixon who, to put it politely, was thrown out of office. Following Richard Nixon we were treated to Gerald Ford, a one-term President who was voted out of office. And now we are blessed with James Earl Carter, and your guess is as good as mine as to how Carter will be separated from the White House (perhaps he'll be carried away by a band of halo-capped angels).

The Carter energy "program" is, to my mind, a hopeless, hopelessly expensive hodge-podge of bureaucracy, dreams, and fuzzy projections. I distrust any economic program or solution that is not based on free market principles. So take it for granted that I distrust the whole Carter approach from one end to the other. Moreover, I have faith that the nation is fast becoming fed-up with our prissy Presidential sermonizer. For that reason, I expect that little or nothing will come out of the Carter plans for a "self-sufficient America."

Front Page Comment: Here's the meat of the Carter "solution" to our energy problems. A phased decontrol of US Crude prices, producing tax revenue which will sift into the Energy Security Trust Fund to the tune of \$142 billion. Three major expenses will be set up for this \$142 billion fund. An Energy Security Corp. will be empowered to spend \$88 billion during 1980-90 to try to boost development of syn-fuels. The fund will also spend \$16.5 billion for public transportation (this will have nothing to do with producing energy). Another \$24 billion will go to low-income assistance or to help people who are inconvenienced by high energy costs!

Thus the Carter program is seen as just another monster tax, a large part of which will be used to redistribute wealth and gather votes. To my mind the Carter plan is characteristic of everything that has been destructive to the US free enterprise system over the past 40 years.

Left alone, the free markets and the law of supply and demand would have solved the energy problem years ago. In fact, it is a testament to America's great resiliency and inner strength that it has survived this long in the face of the Washington manipulators. Already, with higher priced gasoline, US gasoline stocks are running ahead of last year (for the third month in a row). Knock 700 pounds off every US car (which will be happening), cut back on the joy rides (which is happening), let the mopeds and mini-



cars and bicycles loose: (which is happening), and there'll be a glut of gas by 1980!

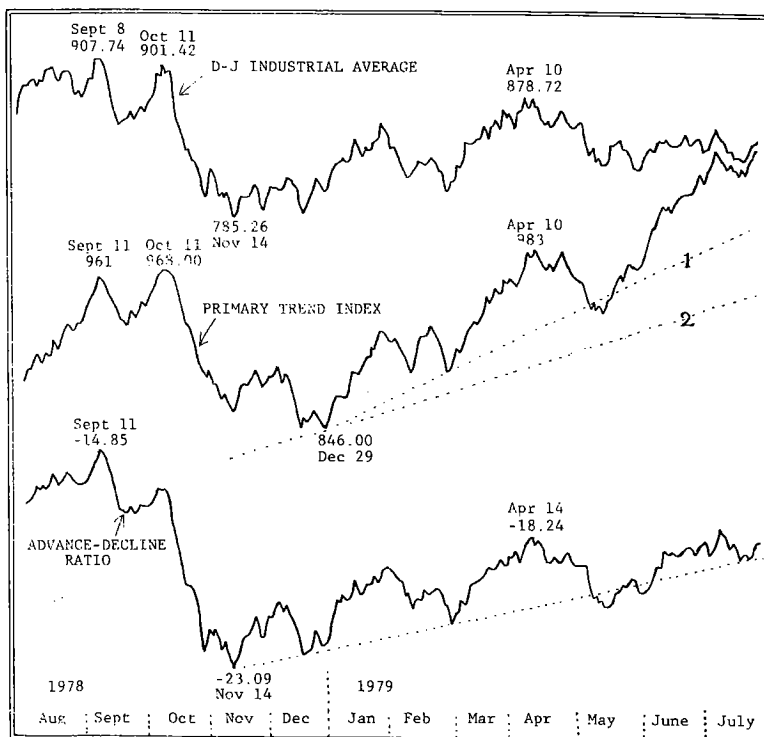
My friend C. V. Myers in his latest outstanding report has said that the US must go the way of coal. I agree. Our salvation is coal (S. Africa is living off of the coal-to-oil process now). I don't think there is any other way to go.

My solution to the energy problem would be to immediately disband the ridiculous Department of Energy and get the Government off the back of private enterprise. Then I'd fully decontrol gas and oil and let the law of supply and demand take over. Freed from its chains, the American system would rush headlong into energy production of all kinds. My bet is that within 5 years the power of OPEC would be broken and we'd have energy "coming out of our ears."

As a matter of fact with Libya's recent 10% cut in oil shipments and Algeria's just announced 20% cut, I suspect that there's an oil (and gas) glut building up now! The world is learning to cut back on fuel use—and fast, and this could turn out to be the shocker of 1979-80 (the gas stations in San Diego are as empty now as they were a year ago).

Thank God for the markets. The markets (immune to Washington's manipulations) cut through the fog and the lies in an instant. The market's reaction to the new Carter schemes was the financial equivalent of a "bronx cheer." Gold pushed to new highs, the dollar turned weak against major currencies and the bond markets sagged. The Dow broke below 830 and on July 18 no less than 6 Dow stocks hit the new low list (duPont, Kodak, IBM, MMM, Proctor and Gamble, Sears).

THE MARKET: I've seen "cute" markets, but this one has to take the cake. So far, the Industrial Average (see page 1 chart) has held pretty well on the downside. It remains to be seen whether it can or will move out on the upside (it hasn't shown any real upside power since late-1976).



On July 23 the Dow sank to 825.51. This was 4 points above the June 21 low of 821.22, which in turn was 14 points above the February 27 low of 807.00. So we can see that the Dow has been building a nice set of rising bottoms. But it's the declining peaks that have been the problem. The nearby targets for the Dow are the 852.99 high of July 9 and the much more important 1979 high for the year at 878.72 (April 10).

The Transportation Average has been hitting new highs (as have Utilities) so it remains to be seen whether the Industrials will confirm. Dow's Theory stipulates that a movement by ONE AVERAGE, unconfirmed by the other, must not be trusted for predictive purposes, and veteran subscribers have learned to respect the wisdom of that concept.

Turning to the page 2 chart of the Primary Trend Index (PTI) and the A-D ratio, I can only say that the PTI has been a "tiger." On "up days" in the market the PTI rises joyfully while on "down days" it retreats reluctantly. This Letter finds the PTI at a new high (!), and I'll repeat again that the stock market cannot go down in any meaningful way while the PTI trends higher. So far, the PTI is in a bull trend. I find any number of things wrong with this market, but all bearishness should be held in abeyance until the PTI traces a pattern that can clearly be labeled a downtrend!

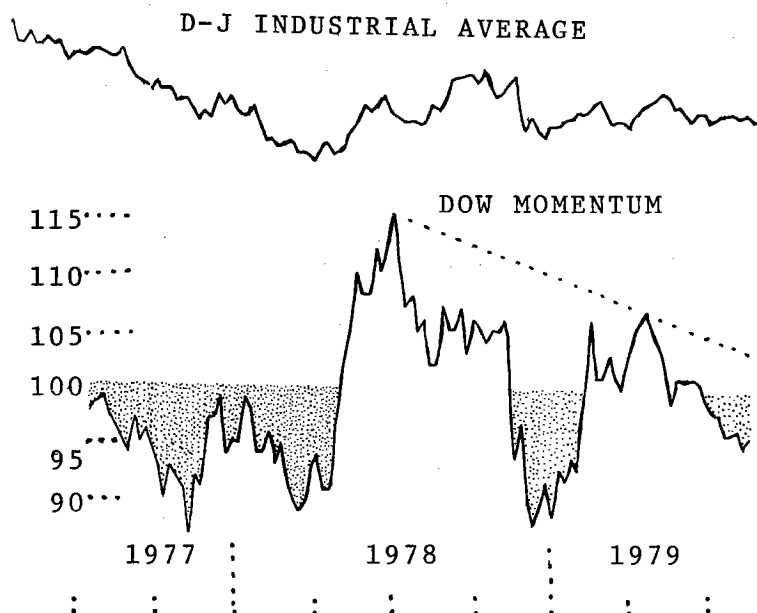
Turning to the bottom of the chart, the A-D ratio has been moving higher in an extended but shallow pattern. The latest peak is still well below the September peak, but the lows have been successively rising. The A-D ratio will remain bullish unless or until its May low is broken.

Last week I was asked this question: "Russell, if you could change any part of your stock approach over the past year, what would you have done?" My answer was, "There are many subscribers who are willing to speculate, and I think I have been too conservative and too stubborn on this issue. The change I would have made is that I would have offered speculative choices for those willing to assume the risk of buying in a market that is not over-sold and not in an ideal buying area."

Well, we're still in that situation. No over-sold and no ideal market buying area. But I believe we are moving into an area where the blue chip stocks are going to outperform the "run of the market" issues. At this time there are 14 out of the 30 Dow stocks with positive 13-week rates of growth. The top Dow stocks in order are Westinghouse, Allied Chemical, Texaco, International Harvester, Standard of California, American Can, Union Carbide, American Brands. A package of 4, 5, or 6 or the full package of 8 should outperform the Dow Industrial Average and probably the general list as well.

I want to add that I personally am buying no shares here. I prefer to wait for the "ideal buying situation." But I recognize that there are people who want to speculate. If you speculate, you might as well do it intelligently—with the right stocks. And the PTI is still powerful, there is simply no denying that.

DOW MOMENTUM: With the recent inclusion of IBM and Merck in the D-J Industrial Average, this most-followed group of 30 leading blue chip industrials now becomes even more important. The reason is that the 30 stocks in the DJIA now represent approximately 30% of the entire value of the NYSE.



I follow a 13-week rate of change for the Dow, and this is commonly known as Dow momentum. Each week I divide the Friday closing price of the Dow by its price 13 weeks before. This provides a very simple rate of change percentage for the Dow. This rate of change index is shown on the accompanying chart.

The momentum index hit a recent peak of 115 on the week ending June 9, 1978. It then turned down, dropping below 100 in October and hitting a low of 88 on November 3. From there, momentum turned up and a new (lower) peak of 107 was recorded on the week of March 30, 1979. By April 27 the momentum index had dropped below 100 again, and the latest reading of the index is 96.

I have found that trendline reversals in the momentum index are usually quite significant. And as is true in so many cases, the longer the trendline the more significant the reversal. The Dow momentum index is particularly useful because we can plot ahead to see what current Dow level is needed for a trendline reversal—in this case a reversal to the upside. As matters stand

now, the Dow would have to rise to 895 to bring the momentum index to 104.

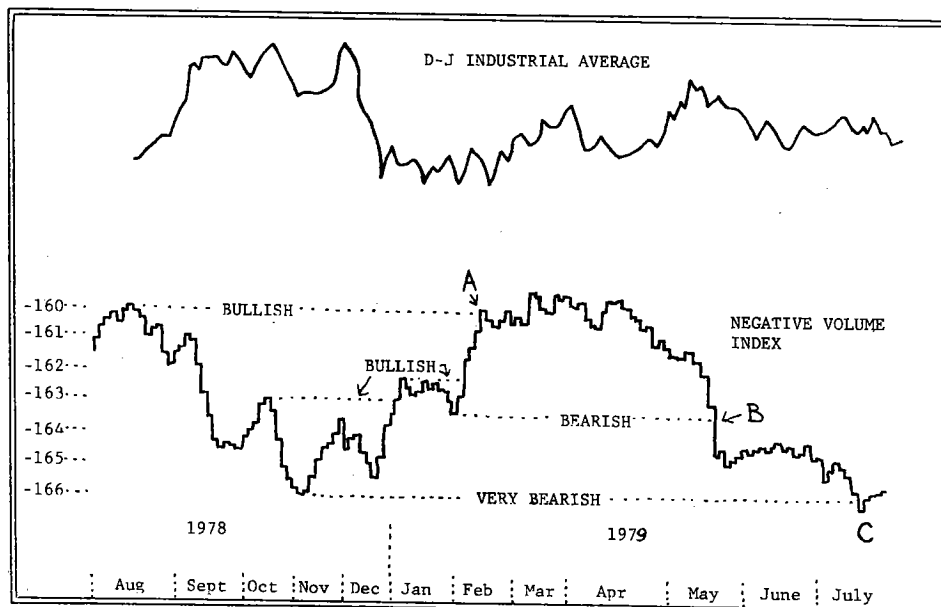
Since the trendline is declining, it will take a lower figure as each week goes by to reverse the Dow momentum index to the plus side. For instance, by November the declining trendline will be down to the 100 level. That means that a momentum figure of 101 or 102 will serve to turn the momentum index bullish—whereas a momentum figure of 104 is needed today. I will keep subscribers up to date on this study.

NEGATIVE VOLUME INDEX: The negative volume (NV) index doesn't "talk" very often but when it does—it's worth listening to. The concept of NV was introduced many decades ago by the late Paul Dysart of Trendways. Dysart reasoned that "big" (important) money prefers to do its buying (and selling) during quiet periods when market volume is low. Conversely, the public tends to move only during exciting markets when volume is high. Thus, the NV index will reflect the all-important action of the big money, the money that moves during quiet markets.

How is the NV index constructed? The NV index is the differentials in the daily advance declines tabulated ONLY on days when NYSE volume is below the preceding day. These differentials are recorded only during those lower volume days, so that theoretically we might have a week in which no NV totals appear (a week in which volume rises each day), and then a week in which NV tabulations are entered every day (this could occur if volume declines for five successive days). The NV tabulations are a running or cumulative total, and it is these totals that I show on the chart.

In my studies of NV, I have seen that the larger the zig-zag prior to a NV signal, the more important that signal. Furthermore, a signal on NV, once given, remains in effect until another counter-mandling signal appears.

Note on the chart that during early January and again during early February, 1978, the NV index gave bullish signals. In mid-February (A on chart) an important bullish signal was given as the NV index rose above its August peak. The NV index then moved sideways into April. During late-April and May I was surprised to see the NV index slide and by mid-May (B) the first bearish signal was given. I thought this signal was important, since it wiped out four months of rise.



In the last Letter I mentioned that a very bearish signal on the negative volume index occurred on July 12 (C). This bearish signal was registered when NV broke below the major low of last November. The July 12 signals thus came 8 months after the November low and it wiped out all the NV gains of late-1978 and all of 1979.

What the July 12 bearish signal is telling us is that it takes big volume to put the market up. But when the market retreats on lower volume, the gains are not sustained. This inability to hold gains (when volume recedes as the market retreats) is a bearish manifestation. It should be followed by ragged or lower breadth in the period ahead.

Conclusion: major signals on the NV index relate most directly to breadth. For this reason, I would say that the rise in the

A-D ratio which began last November has probably come to an end. Hopefully, we are now in the corrective phase which will, in due time, lead to the first major over-sold bottom since 1974.

HORROR STORY: In 1965 duPont hit a record high of 97.87. At that time gold was \$35 an ounce. If you put up an ounce of gold you could then buy about a quarter of a share (.28 shares) of duPont. Today with gold at 303 and duPont at 40 an ounce of gold will buy 7.5 shares of the stock.

In 1965 GM hit a high of 113.75 while gold was \$35. At that time an ounce of gold would buy about a third of a share (.318 shares) of GM. Today an ounce of gold will buy 5 shares of GM.

In 1964 Exxon hit 46.5 with gold at \$35. An ounce of gold would then buy 1.3 shares of Exxon. Today an ounce of gold will buy 5.7 shares of Exxon.

An ounce of gold in 1964 would buy 2.1 shares of American Telephone. Today that ounce will buy 5.3 shares. In February, 1973 an ounce of gold would buy 1.7 shares of IBM (gold then \$54, IBM then 91). Today an ounce of gold will buy 4.4 shares of IBM.

What has happened? I've thought about these frightening trends and I've pondered them in the light of my steadily climbing gold/stock ratio. And the following are some of my conclusions.

Every investment must ultimately be valued on its return. In the stock market that means **dividends**. Ultimately, dividends must be paid if a stock is to be worth anything. I believe that the gold/stock situation is telling us that the return on stocks (dividends) is worth less and less due to inflation. The fact is that no amount of rising dividend return can keep up with the collapse in the dollar's buying power, and that is why the public and even large investors are pouring out of the stock market and into "things," be those things gold, art, collectibles, stamps, you name it.

Consciously or unconsciously, the markets are sensing that inflation is destroying the very meaning of "return on investment." The market is telling us, "What's the good of a 6% or a 9% return on investment (not that many stocks give you that kind of return) when inflation is 13% and perhaps going higher?"

Or look at it another way. A corporation makes \$100 in profits. Immediately, \$50 goes to taxes. Of the remaining \$50, approximately \$25 goes to the stockholder in the form of dividends. Of that \$25, \$12.50 goes for individual taxes. That means that the stockholder keeps a net \$12.50 of every \$100 his investment earns. The truth is that corporate earnings after taxes cannot keep up with inflation, and the market knows it.

Back in the 1950's Hamilton Boulton (founder of the Bank Credit Analyst) used a series to show what was happening with bank credit and the GNP. During 1949-53 it required only a 17-cent increase in bank credit to produce a rise of \$1 in the GNP. During 1958-60 it took 23-cents in additional bank credit to produce an additional \$1 in GNP. During 1960-65 it took 46-cents in bank credit to produce \$1 in additional GNP. By 1966-68 it took \$1.03 to produce an additional \$1 in GNP. During 1975-78 it has taken \$1.38 to produce \$1 in GNP. And during the March, 1978 to March, 1979 period it has taken \$1.88 in bank credit to produce an additional \$1 in GNP!

In other words, it is taking more and more credit to produce less and less GNP. This ominous trend is highly inflationary, an indication of an economy that is bogging down and becoming increasingly fat and inefficient (late figures for this study computed by Ned Davis at J. C. Bradford & Co.).

Now here's an interesting aside on inflation. One of the reasons it's so insidious is that as soon as a man starts protecting himself against it, as soon as he buys a house or a load of gold coins or a painting or a stamp collection—that man wants his inflation hedge to go up. He becomes (deep in his heart) an inflationist. Take housing: the value of total housing in this nation is \$2.2 trillion (two thirds of these houses have mortgages). The last thing these home-owners want is a declining market. They are secretly in favor of rising prices and inflation.

In my opinion, when the fear and pain of inflation overrides the average man's greed—at that time he'll be ready to vote the current crop of "political bums" out of office and bring in the men who will take a real stand against inflation. When America is ready to go through the pain of deflation, they will begin to elect anti-inflationists. But we aren't there yet—not by a long shot.

NOTES AND QUOTES: I like to deal with odds and probabilities. Two of the studies I've followed for more time than I'd like to think about are *Lowry's—Buying Power and Selling Pressure* and the *Bank Credit Analyst*. One is based on strict market action (points gained and lost and upside and downside volume), while the other is based on monetary factors. I've taken these two studies back to 1933 and correlated periods when BOTH studies were bullish and BOTH studies were bearish. During those periods, it would have paid investors to be in harmony with these two studies. There have been no instances of exceptions—until now.

The Bank Credit Analyst's "monetary thermometer" turned bearish in November, 1977, and it has been in the bearish mode ever since. Lowry's studies have been bearish during the same period except for a brief span of August to October, 1978. On October 17 the Lowry study turned bearish again and both studies are still decidedly bearish as of this writing.

Despite the twin bearish modes there has been much upside action on the Amex and the O-T-C, and selected strength on the NYSE. However, based on past history the odds of garnering profits during this period have been very slim. As I say, I hate to go against the odds, and I know that if you make it a policy of trying to beat slim odds you are going to lose your shirt. I don't intend to lose mine—nor those of my subscribers.

A little less than two years ago I wrote that stamp dealer Myron Kaller had purchased the famous Princeton block of inverted center 24-cent airmails for a price of \$220,000, the highest price ever paid for a single philatelic rarity. Last week Myron called to tell me that he had sold this block for \$500,000 (sale partly financed by Morgan Guaranty!). In case you wonder what a half million dollar piece of paper looks like, I include this photo. So much for the world of collectibles.



Americans have been eating one out of every three meals in a restaurant. I can't prove it, but I firmly believe that trend has topped. I believe it because (1) restaurant prices are too high for the average citizen to handle, and (2) restaurants can't compete with good home cooking (and I think restaurant food, in general, is deteriorating).

I also feel that the fast-food boom is about over. A family goes into a fast-food store now, and it costs them \$10 for hamburgers and cokes with some fries.

Finally, I believe the health aspect is becoming important as a national trend. This year for the first time in history chicken has outsold pork. Here in California almost every other person I meet is "off red meat." People here are going "vegie" in a big way, and it should be remembered that trends often start in California and head East.

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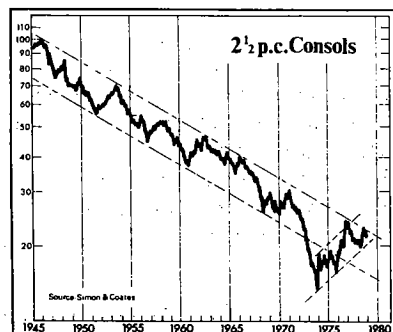
I am willing to bet that this one will have cogent meaning to about one out of every three of my subscribers: "*The darkest hour in a man's life is when he plans to get money without earning it.*" Horace Greeley (thanks to Trendex). I know this has meaning for me. I've only been able to make money buying "values." Whenever I've tried to gamble or speculate I've been a loser. I think Greeley was telling me something.

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Sorry, the address for the book, Taxpayers Counterattack is 901 N. Washington St., Suite 200, Alexandria, VA 22314. I just received another outstanding book ("and still they come") by Douglas Casey entitled Crisis Investing. This book is easy reading and very informative, going into real estate, banks, gold, stocks, and how to survive the whole mess. Doug is not terribly optimistic. The book is \$14.95, published by the '76 Press.

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Commodity traders have had one of their roughest seasons in years. If you weren't in the metals, you probably "got killed." For instance, the October cattle contract is now down from 74.45 to 61, a drop of almost 18%. One trader told me that "It looks like the country is going vegetarian." Live



hogs are much worse, with the October contract dropping from 51 to 32, a drop of 37%. On piggies I was told that they act like "the whole world is going Jewish!"

But it all depends on what market you're in. For instance, here are the famous perpetual (no maturity date) government bonds of Britain, known as the Consols. They're about to break out of a 35-year down-channel! If they go through, pin a gold star on conservative Maggie Thatcher (known to her liberal enemies as "Atilla the Hen"). Laugh, but she may save Britain yet.

GOLD, INTEREST RATES, INFLATION: To the casual observer, it looked like a world embroiled in an interest rate war. And the fact is that rising inflation is being fought all over Europe and Japan—via an interest rate squeeze. The US is a frightened and reluctant follower.

A few weeks ago Germany raised her bank rate. At the same time Britain boosted her borrowing rate a whopping 2%. Last week the US raised its discount rate an insufficient .5% to a record 10%.

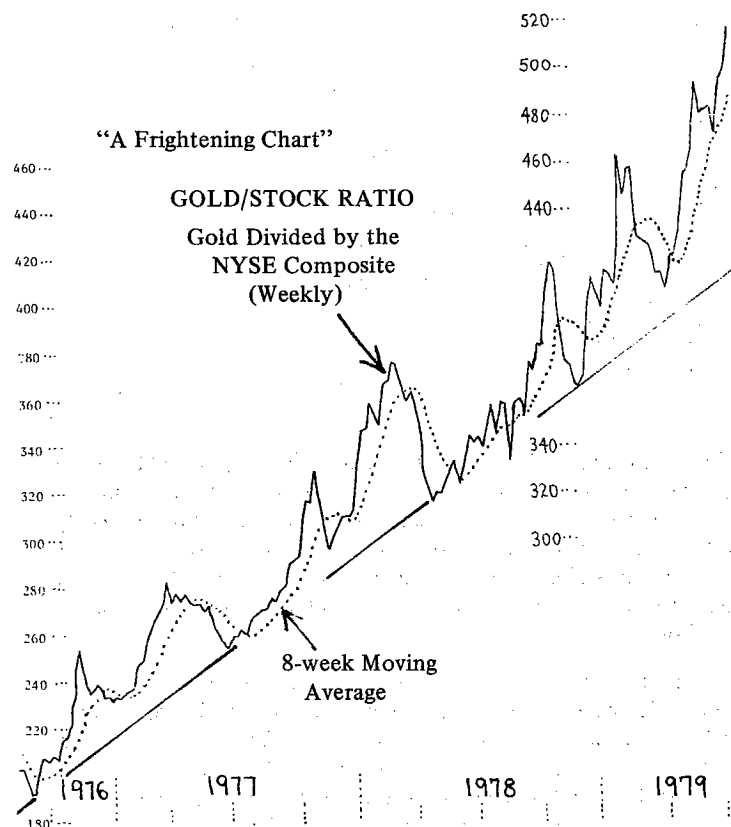
Canada immediately followed with a boost to 11.75% in her bank discount rate. Then Japan jumped her lending fee to institutions a full 1%.

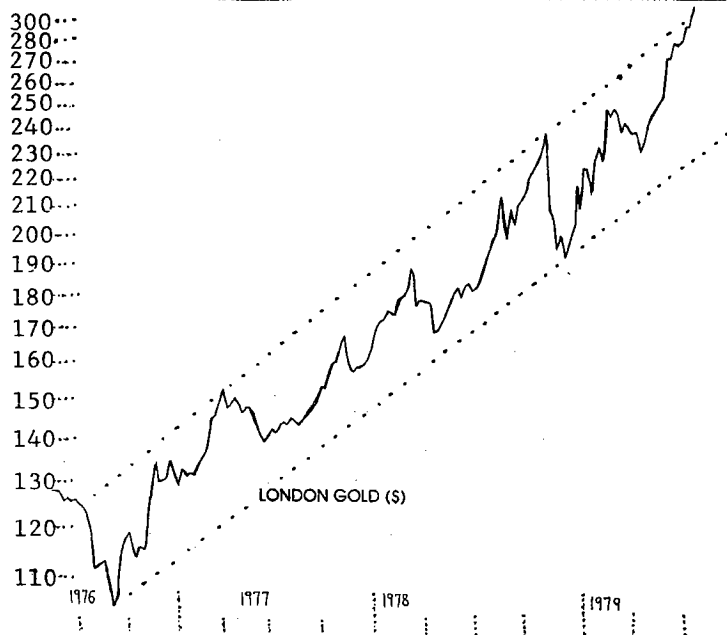
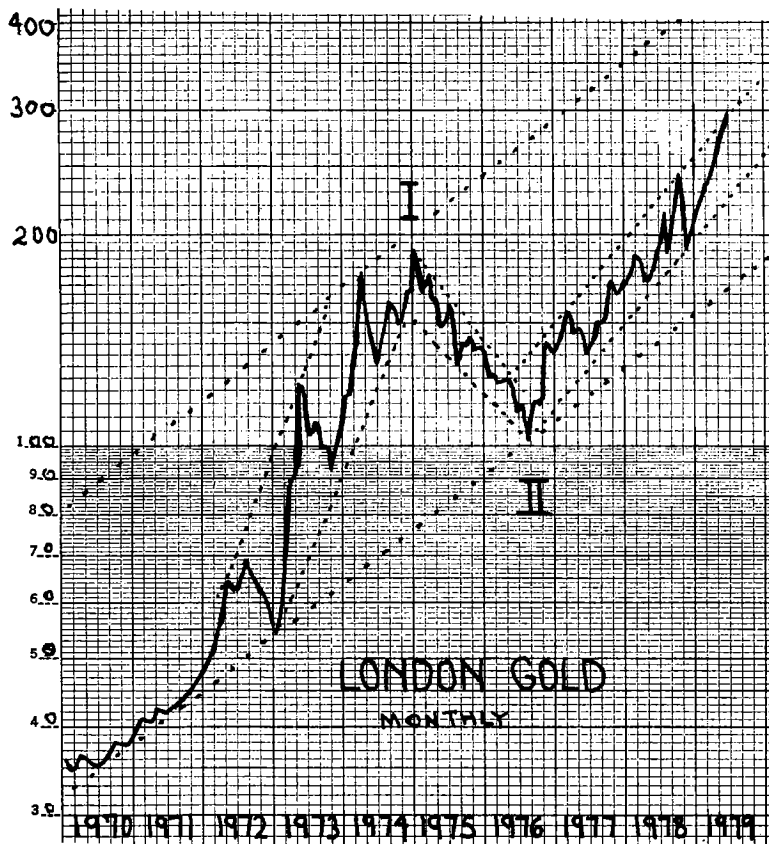
There's a change in the economic picture, and most people in the US are not really aware of it. The change is that the dollar is a currency that is now on the line—day and night, hour after hour. The US has sought (with singular lack of success) to insulate the dollar from the rest of the world. And just as the US is now trying to insulate the price of the oil it uses from world markets, just as the US has tried to hold back the price of gold, the great US manipulation machine is doomed to failure in its battle to hold up the value of the dollar.

For the fact is that every administration since Roosevelt's has lived an economic lie. The lie is that the US can print away its deficits and still survive as the world's leading power. It cannot. As the debts mount, as foreign holders of dollars grow increasingly apprehensive, the move towards the exits intensifies. And the US, now the greatest consuming machine the world has ever seen, is finally facing its moment of truth.

Those of us who have seen this coming still have a single answer to the question, "How do we lick inflation." The answer: "Vote these ignorant and dangerous political adventurers out of Washington and vote in trustworthy men who understand that 2 and 2 equals 4 (even though every liberal economist hates that simple bit of turth).

And what do I do? I give lectures, and I write my Congressmen and Senators, I curse and I fume, and I continue to show my chart of charts—the ratio of gold to stocks. And I might just as well show that chart again in this Letter. For what we see here is probably the most relentless trend in the US markets today. It is the ratio derived from simply dividing the gold price by the value of the NYSE Composite. Day after day this ratio climbs higher, and it is clear to me that shortly, very shortly, SOMETHING IS GOING TO GIVE.





The happiest analysis of this chart is that the rising trend has been in effect for a long time (three years), and the ratio is now pulling far away from its basic up-trend line. Thus, we could be seeing a "blow-off" in the ratio with gold now showing at the peak of its strength against stocks. If so—IF the ratio turns down in the near future this would be a very hopeful sign. So let's watch it—and hope!

GOLD: I include two chart views of gold. In general I prefer ratio-scale charts to arithmetic since all trendlines drawn on ratio scale denote a steady rate of growth. The first chart shows the three major swings in gold since 1971: (1) The great rise to the 1974 peak of 193, (2) The drastic correction to the 1976 low of 103; and (3) the latest extended advance to 307. I have placed all of these movements within the confines of a huge rising "super-

channel." By the end of 1979 the bottom of this channel will be about 190.

The second chart is merely an enlargement of the 1976-79 rise, this also on ratio scale. As you can see, the latest advance has taken gold just above the upper channel line. As a rule, any rise above the upper channel line in this kind of movement should be labeled a "blow-off" move, and this may be what gold is getting into—assuming it can push decisively above the 310 level in the very near future.

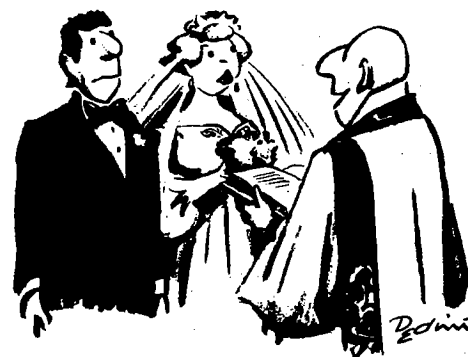
The gold rise is growing old, and it would seem to have every reason to correct. If it does not, I will draw the conclusion that this nation and its currency is in even worse straits than the dismal news (on the dollar) would have us believe. After all, Washington is actually cheering the latest monthly balance-of-trade deficit because it is under \$2 billion. If that isn't cause for hand-wringing I don't know what is.

Mr. Volcker has now been placed in the position of guardian of the nation's currency. We'll know soon enough whether he is just another in a long line of monetary "pussycats." And if anyone can tell me why Mr. Miller gave up his independent position as Fed Chairman for a job in which he reports to Mr. Hamilton Jordan, drop me a line and let me know. I'm really curious.

LATE NOTES: The PTI is at a new high, and one subscriber asked, "Russell, when are you going to be as bullish as your own PTI?" I've only had experience with the PTI for 8 years, and I've frankly been a bit skeptical about it. My skepticism was misplaced. The PTI has been a superb indicator, and I'm going to give it much more prominence in my thinking. I've seen it tell its story during a crash (1973-74) and during the difficult times since. It has proved a very accurate indicator.

I don't know why the PTI keeps going up—but it does! Last week I suggested Madison Fund and US & Foreign Securities as longer-term holdings in any diversification program. This week I listed the strongest Dow stocks with the stipulation that speculators might find the list worth experimenting with. I believe the critical downside level on the Dow is 815. As long as the Dow can hold above that level, the trend must be accepted (particularly in view of the PTI) as up.

NEXT MAILING: August 15th



"And do you promise to stick together during the coming crunch?"

courtesy, New Yorker